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ARBITRAL AWARDS – AUTOMATIC STAYS, ON? AND CASUS OMISSUS FOR IBC

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INTRODUCTION

On 27 November 2019, a three-judge bench of the Hon'ble Supreme Court delivered its much-awaited judgment in the case of *Hindustan Construction Company Limited & Anr v Union of India, Writ Petition (Civil) No. 1074 of 2019* and put to rest the debate around section 87 of the Arbitration and Conciliation Act, 1996 (Arbitration Act) as inserted by the Arbitration and Conciliation (Amendment) Act, 2019 (2019 Amendment Act). The Supreme Court struck down the insertion of Section 87 into the Arbitration Act and deletion of Section 26 of the Arbitration and Conciliation (Amendment) Act, 2015 (2015 Amendment Act) as being manifestly arbitrary under Article 14 of the Constitution of India.

The Supreme Court also rejected the constitutional challenge to read down the definition of "corporate person" under Section 3(7) of the Insolvency and Bankruptcy Code, 2016 (IBC) so as to suggest that government bodies should be included as corporate debtor.

MARCH OF LAW ON APPLICABILITY OF THE 2015 AMENDMENT ACT

The 2015 Amendment Act which came into force from 23 October 2015 introduced certain game-changing amendments to the Arbitration Act. Pertinently, Section 34 was amended to narrow down the scope of challenge to an arbitral award and section 36 was amended to do away with the automatic stay on an arbitral award which came into play at the instance of the award debtor filing a challenge petition under Section 34. In light of the drastic implications of these amendments on ongoing arbitral proceedings and connected court proceedings, there arose a controversy with respect to the prospective-retrospective application of the 2015 Amendment Act.

Section 26 of the 2015 Amendment Act provided that:

> "***Act not to apply to pending arbitral proceedings****: Nothing contained in this Act shall apply to the arbitral proceedings commenced, in accordance with the provisions of Section 21 of the principal Act, before the commencement of this Act unless the parties otherwise agree but this Act shall apply in relation to arbitral proceedings commenced on or after the date of commencement of this Act."*

The question of interpretation of this provision fell before the Supreme Court in *BCCI v Kochi Cricket Pvt Ltd (2018) 6 SCC 287* (*BCCI*). The Supreme Court held that the 2015 Amendment Act was to apply prospectively to arbitral proceedings i.e. it would not

apply to arbitral proceedings commenced prior to the commencement of the 2015 Amendment Act. However where court proceedings under Section 36 are concerned, the amended Section 36 (*vide* the 2015 Amendment Act) would apply irrespective of the date of commencement of the arbitral proceedings. Accordingly, this meant that in case an arbitral award delivered pre or post the commencement of the 2015 Amendment Act is challenged in court, the amended Section 36 would be applicable and there would be no automatic stay on its execution.

Despite the *BCCI* case clarifying the position of law and criticizing the proposed Section 87 which formed part of the Arbitration and Conciliation (Amendment) Bill 2018 at that point of time, the Government relied on Report of the High-Level Committee to Review the Institutionalisation of Arbitration Mechanism in India headed by Retd. Justice B N Srikrishna (Justice Srikrishna Committee Report) and introduced Section 87 *vide* the 2019 Amendment Act.

Section 87 states that unless the parties agree, the provisions of the 2015 Amendment Act will not apply to arbitral proceedings commenced prior to commencement of 2015 Amendment Act and to court proceedings arising out of or in relation to such arbitral proceedings, irrespective of whether such court proceedings commenced prior to or after the commencement of the 2015 Amendment Act.

This effectively meant that in cases where the arbitral proceedings commenced prior to the 2015 Amendment Act, even if the subsequent court proceedings for challenging the arbitral award were initiated after the commencement of the 2015 Amendment Act, the 2015 Amendment Act would not apply to the court proceedings. Resultantly, the courts would have to apply the unamended provisions of the Arbitration Act and that would mean the benefits such as those under the Section 36 (as amended *vide* the 2015 Amendment Act), which stated that mere filing of an application challenging the arbitral award would not result in automatic stay, would not yield to the benefit of the award creditor.

The 2019 Amendment Act also deleted Section 26 of the 2015 Amendment Act to give full effect to Section 87 and avoid any overlap.

FACTUAL BACKGROUND

The Petitioner, Hindustan Construction Company Limited (HCC), is an infrastructure company involved in the business of large scale infrastructure projects undertook these projects as a contractor for various government bodies and government companies like the NHAI, NHPC, NTPC, IRCON International and various public works department.

Due to the nature of these projects and the cost overruns involved, HCC eventually had disputes with these government bodies and government companies. In the arbitral proceedings that ensued, several awards were passed in favour of HCC. These awards were challenged pursuant to the provisions of Section 34 of the Arbitration Act. Invariably, due to the newly inserted Section 87, by such challenges to the arbitral awards, the award debtors (i.e. the government companies and government bodies) were successful in getting automatic stays on the execution proceedings. HCC's primary contention was that this would further delay the process of enforcement of an arbitral award and create new hurdles for companies like HCC who are *bona fide* award creditors.

Additionally, this meant a double whammy for HCC. On one hand, filing of challenge to the arbitral award would be construed a disputed debt for the purposes of IBC and if any petitions were filed by HCC as an operational creditor, the same would be rejected as not maintainable, and on the other hand, various operational creditors that had supplied labour and machinery for such projects, were issuing demand notices to HCC.

In light of this, HCC sought to challenge the constitutional validity of Section 87 of the Arbitration Act, deletion of Section 26 of the 2015 Amendment Act and certain provisions of the IBC.

ARGUMENTS OF THE PARTIES

By HCC:

HCC argued that the Arbitration Act is based upon the UNCITRAL Model Law on International Commercial Arbitration. Article 36(2) of UNCITRAL Model Law provided that in case applications are filed for setting aside or suspending an award, the other party may be required to provide security. However, Section 36 of the Arbitration Act has been construed as granting an 'automatic stay' when an application to set aside an arbitral award is filed and this was incorrect.

It was also submitted by HCC that despite the *BCCI* decision, Section 87 was introduced. The *BCCI* decision was brought to the notice of the Ministry of Law and Justice, but the legislature solely relied on the Justice Srikrishna Committee Report and went ahead and enacted Section 87. As a result, the basis of the *BCCI* decision was sought to be removed without even a mention of the same, thereby making enactment of Section 87 unconstitutional.

HCC also argued that Section 87 destroyed a level playing field in relation to enforcement of arbitral awards by re-imposing an arbitrary cut-off date *qua* application of the amended Section 36. It was further submitted that introduction of Section 87 was also against the principle of cutting down judicial delays and minimum court intervention in arbitral process, as espoused by Section 5 of the Arbitration Act.

With regard to challenges faced by it due to IBC, HCC submitted that exclusion of government bodies from the ambit of IBC was arbitrary, discriminatory and violative of Articles 14 and 19(1)(g) of the Constitution of India. Accordingly, either the definition of 'corporate person' as contained in section 3(7) of the Insolvency Code should be read down without the words "with limited liability" in the third part of the definition, or section 3(23)(g) which defines 'person' should be read into section 3(7) so as to create a level playing field and include government bodies.

It was submitted by HCC that the IBC mechanism was absent for forcing debtors of a corporate debtor to make payments, to avoid insolvency of such corporate debtors and therefore the Court should accordingly fill the gaps to save IBC by using the doctrine of '*cassus omissus*'. HCC also argued that the IBC should provide for a set-off mechanism to deal with a situation where the corporate debtor has debtors of its own.

By Union of India:

Union of India submitted that the interpretation given to Section 26 of the Arbitration Act in the *BCCI* decision was only declaratory in nature and did not set aside either an executive action or a statutory provision. Accordingly, if the Parliament finds that a view expressed by Supreme Court does not reflect the Parliament's original intent, then the parliament can rectify the same and clarify its original intent through an amendment.

This is in fact what has been done by deleting Section 26 and inserting Section 87.

As regards the constitutional challenge to the provisions of IBC was concerned, it was submitted that a writ petition under Article 32 of the Constitution of India cannot be converted into recovery proceedings. The IBC is not a statute for recovery of debts, but is a statute for reorganization of corporate persons and resolution of stressed assets of corporate persons. Whilst government companies fall within the ambit of IBC,

government bodies like NHAI are outside the realm of IBC because these bodies function as an extended limb of the government and carry out sovereign functions.

JUDGMENT

Constitutional challenge to Section 87:

The Supreme Court held that insertion of Section 87 and deletion of Section 26 of the Arbitration Act was unconstitutional on the ground of manifest arbitrariness.

It was of the view that Section 87 was introduced pursuant to the Justice Srikrishna Committee Report. The Supreme Court knew of the Srikrishna Committee Report when deciding the *BCCI* case. The inconsistencies or uncertainties that existed with regard to commencement and applicability of the 2015 Amendment Act, were all put to rest by the *BCCI* judgment. The introduction of Section 87 was wholly without justification and was contrary to the objectives of the 2015 Amendment Act. In the *BCCI* decision, the Supreme Court had emphasized that provisions such as Section 87 would turn the clock backwards and put all important amendments as introduced by the 2015 Amendment Act on the backburner.

The Supreme Court opined that the 2015 Amendment Act corrected the mischief of misconstruction of Section 36 after a period of more than 19 years.

The Supreme Court also held that its earlier decisions in *National Aluminium Company Ltd v Pressteel & Fabrications (P) Ltd & Anr (2004 1 SCC 540* and*Fiza Developers and Inter-trade Pvt Ltd v AMCI (India) Pvt Ltd and Anr (2009) 17 SCC 796,* where it was held that an arbitral award when challenged, becomes inexecutable and an unconditional automatic stay comes into play because of the language of Section 36, were plainly incorrect.

Constitutional challenge to certain provisions of IBC:

The Supreme Court held that government bodies such as NHAI were essentially an extended limb of the government and performed governmental functions, which makes them unamenable to the provisions of the IBC. Therefore, the Supreme Court rejected HCC's argument to either read Section 3(23)(g) in Section 3(7) or read down the definition of 'corporate person' in section 3(7) of the Insolvency Code so as to include government bodies even if they are not limited liability corporations.

The Supreme Court also refused to exercise the doctrine of *cassus omissus*, so as to provide an IBC mechanism for forcing debtors of a corporate debtor to make payments, to avoid insolvency of such corporate debtors. The Court was of the view that being an economic legislation, IBC has a higher threshold of challenge and gives the Parliament a free play in the joints.

CONCLUSION

This judgment reinstates the position of law as it stood after the Supreme Court's decision in *BCCI* and saves the amendments such as those to Section 36 from being put on a back burner.

Resultantly, where fresh court proceedings such as challenge to an arbitral award are concerned (i.e. court proceedings initiated after 23 October 2015), then irrespective of commencement of arbitral proceedings (i.e. whether prior to or after the commencement of the 2015 Arbitration Act) the 2015 Amendment Act will apply.

This would effectively mean that even if parties challenge an arbitral award today, which was passed in an arbitration which commenced prior to 2015 Amendment Act, the provisions of 2015 Amendment Act will apply. Consequently, there will be no

automatic stay merely on filing of a court proceeding challenging the arbitral award. Pertinently, the Supreme Court has clarified that even the unamended Section 36 (i.e. as originally incorporated in the Arbitration Act) never meant that mere challenge to the arbitral award would kickstart an automatic stay and render the award inexecutable.

Cumulatively, unless the award debtor is successful in getting a stay on the arbitral award, the award can be enforced immediately. Further, before granting a stay on enforcement of an arbitral award, the Courts may impose certain conditions in order to ensure the *bona fides* of the party seeking to challenge the award.

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